ST 00-23
Tax Type: Sales Tax
Issue: Responsible Corporate Officer – Failure to File or Pay Tax

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS,	No. 99-ST-0055 NPL AAAA (JOHN DOE) NPL BBBB (JIM DOE) NOD CCCC (JOHN DOE) NOD DDDD (JIM DOE) Period: 7/93, 8/93, 9/93, 12/93, 9/94, 12/94, 1/95, 3/Q/93-1/Q/94, 1/Q/95
v.	
JOHN DOE AND JIM DOE, TAXPAYERS	**Ted Sherrod Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Attorney General Gary Stutland on behalf of the Illinois Department of Revenue; George Skontos, Esq. on behalf of JOHN DOE and JIM DOE.

Synopsis:

This matter arose after the Illinois Department of Revenue ("Department") issued a notice of penalty liability ("NPL") and a notice of deficiency ("NOD") to JOHN DOE (NPL AAAA; NOD CCCC) and to JIM DOE (NPL BBBB; NOD DDDD) regarding the corporate liability of DOE Specialties, Inc. Both of these individuals timely protested the

NPLs and NODs. Pursuant to a prehearing order, the parties identified the issues to be resolved at hearing as "whether JOHN DOE and JIM DOE were the responsible officers/ employees of DOE Specialties, Inc. who willfully failed to remit or willfully evaded the payment" of retailers' occupation taxes and withholding taxes to the Department of Revenue ("Department") for the tax periods of 7/93; 8/93; 9/93; 12/93; 9/94; 12/94; 1/95; the 3d quarter of 1993, the 4th quarter of 1993, the 1st quarter of 1994, and the 1st quarter of 1995 (herein the "tax periods"). Following submission of evidence and a review of the documents of record, it is recommended that the notices of penalty liability and notices of deficiency issued to JOHN DOE and to JIM DOE be affirmed and finalized as issued.

<u>Findings of Fact:</u>

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of: a) Notice of Penalty Liability AAAA, dated September 6, 1996, showing a penalty liability for JOHN DOE in the amount of $234,336.43 for the periods 7/93, 8/93, 9/93, 12/93, 9/94, 12/94 and 1/95; b) Notice of Penalty Liability BBBB, dated September 6, 1996, showing a penalty liability for JIM DOE in the amount of $234,336.43 for the periods 7/93, 8/93, 9/93, 12/93, 9/94, 12/94 and 1/95; c) Notice of Deficiency CCCC, dated September 7, 1996, showing a penalty liability for JOHN DOE in the amount of $27,976 for the periods 3/Q/93 – 1/Q/94 and 1/Q/95; and d) Notice of Deficiency DDDD, dated September 7, 1996, showing a penalty liability for JIM DOE in the amount of $27,976 for the periods 3/Q/93 – 1/Q/94 and 1/Q/95. Dept. Ex. Nos. 1,2. [1]

2. DOE Specialties, Inc. ("DOE") was an Illinois corporation located at Wherever, Illinois. Tr. p. 62; Dept. Ex. Nos. 1, 2.

3. DOE was in the retailing business. Tr. p. 41.

4. DOE was founded in the late 1960s. Tr. p. 29.

5. JOHN DOE owned 37 ½ percent of the stock of DOE, his wife owned 37 ½ percent and JIM DOE owned 25 percent. Tr. p. 28.

6. JOHN DOE was a director and Chairman of the Board of DOE. Tr. pp. 28, 29, 87.

7. JOHN DOE was the sole director of DOE during the period covered by the company's 1994 annual report. Dept. Ex. Nos. 1, 2.

8. JOHN DOE was paid a stipend of approximately $9,000 in 1993 and $3,000 in 1994 for serving as a director. Tr. p. 33.

9. JOHN DOE was a founder of DOE, and an officer and employee of the company prior to the tax periods in controversy. Tr. pp. 29, 30.

10. JOHN DOE personally loaned between $200,000 and $300,000 in cash to DOE. Tr. pp. 31, 32.

11. JOHN DOE guaranteed bank loans from Capital Bank to DOE of approximately $1.8 million. Tr. p. 32.

12. DOE defaulted on its loans from Capital Bank, and JOHN DOE was required to personally repay these loans. Tr. pp. 32, 73.

13. DOE never repaid the cash loans it received from JOHN DOE or reimbursed him for the payments he made to Capital Bank on its behalf. Tr. pp. 31, 32.

14. JOHN DOE demanded repayment of the loans he made to DOE throughout the tax periods in controversy. Tr. pp. 52, 109.

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[1] Unless otherwise noted, findings of fact apply to the tax periods.

15. JOHN DOE was aware that DOE had a "cash flow problem" throughout the tax periods in controversy; the purpose of his loans to DOE was to address this problem. Tr. p. 52.

16. JOHN DOE owned property that DOE occupied as a tenant. Tr. p. 40.

17. DOE was responsible for paying JOHN DOE rent pursuant to its lease agreement with him. Tr. p. 63.

18. DOE failed to make all rent payments that were due during 1993, 1994 and 1995. Tr. p. 63.

19. JOHN DOE attended informal DOE business meetings which also included JIM DOE, in 1993 and 1994. Tr. pp. 60, 61, 73, 74.

20. JOHN DOE was an authorized signator on DOE's account at Capital Bank. Tr. p. 68.

21. JOHN DOE signed certain loan documents for a loan that was taken out by DOE. Tr. p. 40.

22. DOE filed for bankruptcy in January, 1994. Tr. pp. 96, 97.

23. DOE's liabilities for unpaid taxes owed to the Department were listed in the company's bankruptcy petition. Tr. p. 97.

24. JOHN DOE was advised of DOE's bankruptcy filing. Tr. pp. 68, 69.

25. JOHN DOE suspected that DOE was having financial difficulties prior to being notified of the bankruptcy filing because the corporation did not repay the money it owed him. Tr. p. 69.

26. Prior to and during the tax periods in controversy, JOHN DOE was involved in many different types of business, including the currency exchange business, real estate, wholesale and manufacturing. Tr. p. 77.

27. JIM DOE is the son of JOHN DOE. Tr. pp. 42, 70.

28. JIM DOE was President and Chief Executive Officer of DOE. Tr. p. 87.

29. JIM DOE had responsibility for DOE's tax compliance. Tr. pp. 82, 92, 93.

30. JIM DOE had control over the management and operation of DOE, and was responsible for it's financial affairs. Tr. pp. 90, 91, 94, 146, 147.

31. JIM DOE was responsible for determining which DOE debts would be paid. Tr. pp. 106, 146.

32. RON DOE was controller of DOE. Tr. p. 132.

33. RON DOE prepared DOE's tax returns under the direction of JIM DOE. Tr. pp. 92, 93.

34. JIM DOE signed some of DOE's sales tax returns. Tr. p. 101.

35. JIM DOE personally guaranteed a loan to DOE from Capital Bank. Tr. p. 108.

36. Books and records were kept and financial statements were prepared for DOE during the tax periods. Tr. p. 110.

37. DOE's shareholders had access to the company's books and records. Tr. p. 115.

38. A liquidator was appointed by the bankruptcy court to dispose of the assets of DOE in March, 1995. Tr. p. 118.

39. DOE ceased doing business in March, 1995. Tr. pp. 128, 142.

<u>Conclusions of Law:</u>

Illinois law in effect prior to January 1, 1994 provides that the Department may assess a tax penalty against certain individuals for the unpaid Retailers' Occupation Tax liability of a retail corporation. Ill. Rev. Stat. 1991, ch. 120, ¶452 ½. [2] This liability, which survives the dissolution of the corporation, attaches to:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed… and who wilfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon…

Id.

Similarly, Section 1002(d) of the Illinois Income Tax Act, Ill. Rev. Stat. 1991, ch. 120, par. 10-1002(d), as in effect prior to January 1, 1994, provides:

> **Willful failure to collect and pay over tax**. Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. The penalties provided under subsections (a) or (b) shall not be imposed for any offense to which this subsection applies. For purposes of this subsection, the term "person" includes an individual, corporation or partnership, or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, who as such officer, employee or member is under a duty to perform the act in respect of which the violation occurs.

Id.[3]

[2] This personal liability penalty was replaced by §3-7 of the Uniform Penalty and Interest Act (35 **ILCS** 735/3-1 *et seq.*,) effective January 1, 1994. 35 **ILCS** 735/3-7

[3] This personal liability penalty was replaced by §3-7 of the Uniform Penalty and Interest Act (35 **ILCS** 735/3-1 *et seq.*) effective January 1, 1994. 35 **ILCS** 735/3-7

Illinois law in effect on and after January 1, 1994 provides that the Department may assess a tax penalty imposed by 35 **ILCS** 735/3-7 against certain individuals for the unpaid retailers' occupation tax liability of a retail corporation. Similarly, Section 1002(d) of the Illinois Income Tax Act, 35 **ILCS** 5/101 *et seq.* provides that the penalty provided by Section 3-7 of the Uniform Penalty and Interest Act ("UPIA"), 35 **ILCS** 735/3-7 may be imposed upon: "(A)ny person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof". *See* 35 **ILCS** 5/1002(d).

In light of the foregoing, the issues to be decided in this case are whether JOHN DOE and JIM DOE should be held personally liable for unpaid retailers' occupation tax and withholding tax pursuant to Ill. Rev. Stat. 1991, ch. 120, ¶452 ½ ("¶452 ½") and Ill. Rev. Stat. 1991, ch. 120, par 10-1002(d) ("Section 1002(d)") for tax periods ending prior to January 1, 1994, and should be held personally liable for unpaid retailers' occupation tax and withholding tax pursuant to 35 **ILCS** 735/3-7 for tax periods beginning on or after January 1, 1994.

To impose personal liability for the failure to pay retailers' occupation taxes and withholding taxes under each of the foregoing provisions, it must be shown that the person is a responsible party and that the failure to pay was willful. By introducing the notices of penalty liability and notices of deficiency into evidence, the Department established its *prima facie* case against the taxpayers. In Branson v. Department of Revenue, 168 Ill. 2d 247 (1995), the Illinois Supreme Court held that the admission of the Notice of Penalty Liability into evidence established all of the statutory requirements for imposition of the penalty, including willfulness. While the Court was addressing ¶452 ½ (which is also Section 13 ½ of the Retailers' Occupation Tax Act, 35 **ILCS** 120/1 *et seq.*), rather than Section 1002(d), or Section 3-7 of the UPIA, a comparison of all of these provisions reveals that they are almost identical, and all enumerate corporate officer and employee penalty liability. Moreover, all of these provisions address willfulness and responsibility. Therefore, a similar analysis of Section 1002(d) and Section 3-7 of the UPIA, based on the court's conclusions may be made. Frowner v. Chicago Transit Authority, 25 Ill. App. 312 (1960).

Applying Branson, the notices of penalty liability and notices of deficiency introduced by the Department established the Department's *prima facie* case that JOHN DOE and JIM DOE were responsible officers who willfully failed to pay retailers' occupation taxes and withholding taxes. The burden then shifts to these taxpayers to overcome the presumption of liability through sufficient, competent evidence that they were not responsible officers or employees, or that their actions were not willful. *Id.*

Personal liability under ¶452 ½, Section 1002(d) and Section 3-7 of the UPIA is imposed on one who is "responsible" for the filing of tax returns and payment of taxes shown to be due thereon, who willfully fails to file and/or pay such taxes. None of these provisions define "responsible" person or "willful" conduct. However, the Illinois Supreme Court, in cases wherein it has considered personal liability, has referred to interpretations of similar language in section 6672 of the Internal Revenue Code (26 U.S.C. §6672), which imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes. Branson v. Department of Revenue, 168 Ill. 2d 247 (1995);

Department of Revenue v. Heartland Investments, Inc., 106 Ill. 2d 19 (1985); Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill. 2d 568 (1977).

JOHN DOE argues that he was not a responsible party during any of the tax periods in controversy and that he did not act willfully in failing to remit the pertinent taxes. Tr. pp. 22, 23, 188, 189. Therefore, he argues that liability for the taxes that have been assessed cannot attach to him. Tr. p. 199.

Federal courts have addressed officer/ employee liability with respect to who is considered "responsible" for §6672 purposes. The courts have considered specific facts in determining whether individuals were "responsible" for the payment of employee taxes, to wit: 1) the duties of the officer as outlined in the corporate by-laws; 2) the ability of the individual to sign checks of the corporation; 3) the identity of the officers, directors, and shareholders of the corporation; 4) the identity of the individuals who hired and fired employees; and, 5) the identity of the individuals who were in control of the financial affairs of the corporation. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), cert. den. 400 U.S. 821 (1970); Gephart v. United States, 818 F. 2d 469 (6th Cir. 1987); Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990).

Responsible persons may include officers who can borrow money on behalf of the corporation (Peterson v. United States, *supra*), and may be those with check writing authority who may or may not be the ones with the responsibility for accounting, bookkeeping or the making of payments to creditors. Monday v. United States, *supra*; Wright v. United States, 809 F. 2d 425 (7th Cir. 1987); Calderone v. United States, 799 F. 2d 254 (6th Cir. 1986). There may be more than one responsible person in a corporation. Monday v. United States, *supra*; Williams v. United States, 931 F. 2d 805, 810 n.7 (11th Cir. 1991).

In determining whether a person is a responsible officer, the courts have indicated that liability is not in all cases limited to those who occupy formal corporate office or traditional employee status. Fiataruolo v. United States, 8 F. 3d 930, 938 (2nd Cir. 1993) ("It should be noted that a person need not hold any particular position in a business and need not actually exercise authority to be held a responsible party for the payment of withheld taxes".); Adams v. United States, 504 F. 2d 73 (7th Cir. 1974). Rather, liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. Monday v. United States, *supra.*

Applying the criteria followed by the courts in addressing officer liability, I have concluded that JOHN DOE is a "responsible" officer under ¶452 ½, Section 1002(d) and Section 3-7 of the UPIA. During the tax periods he was Chairman of the Board and, along with his wife, held a majority of the corporation's stock. He testified that he had authority to sign checks on behalf of DOE (Tr. p. 68). He executed loan documents on behalf of the corporation (Tr. p. 40). As the sole director of the corporation for at least a portion of the tax periods in controversy (*see* Dept. Ex. Nos. 1, 2) he had the legal authority to fire the corporation's principal employee, the corporation's President, JIM DOE. *See* 805 **ILCS** 5/8.55 ("Any officer or agent may be removed by the board of directors whenever in its judgment the best interests of the corporation will be served thereby…"). Further, in Illinois, a director of a corporation has been found to be a corporate officer. Lauglin v. Geer, 121 Ill. App. 534 (1905).

JOHN DOE was an experienced businessman, with extensive experience in the retailing business as well as in numerous other enterprises. In spite of this fact, he chose to delegate to his less experienced son the decisions as to what creditors were to be paid, and chose not to be involved in the day to day operations of the business. Mr. Weiss' decision to delegate these responsibilities to another did not make him any less of a "responsible" officer of DOE. Responsibility is a matter of status, duty and authority, not necessarily knowledge. Mazo v. United States, 591 F. 2d 1151 (5th Cir. 1979).

During the evidentiary hearing, testimony was received regarding JOHN DOE' ignorance of DOE's financial problems prior to DOE's bankruptcy filing. Tr. pp. 68, 69, 98. JOHN DOE testified that, while he attended informal business meetings of DOE, he did not find out about these problems at them because the business affairs of the company were hardly ever discussed. Tr. p. 60. JIM DOE testified that this information was deliberately kept from his father (Tr. p. 98), and that, even though he was a shareholder, he was denied complete access to the corporation's books and records. Tr. p. 111. This testimony conflicts with the evidence, cited in my findings of fact, that JOHN DOE lent money to DOE during the tax periods in controversy because he was aware that the company was having "cash flow" problems, and signed for and guaranteed loans to the company that he was required to repay when the company defaulted. Moreover, JOHN DOE admits that he suspected the company was having financial problems prior to being notified of the bankruptcy filing because the company did not repay the money it owed him. Tr. p. 69. Consequently, I do not find the testimony concerning JOHN DOE' ignorance of DOE's financial state prior to its bankruptcy filing to be credible. Based on this determination, and on the evidence and testimony summarized above, I conclude that

JOHN DOE failed to rebut the Department's *prima facie* case that he was a responsible officer of DOE. Thus, the only remaining question is whether JOHN DOE "willfully" failed to remit the taxes that are in controversy.

The willfulness requirement "is satisfied if the responsible person acts with reckless disregard of a known risk that the trust funds may not be remitted to the Government…" Garsky v. United States, 600 F. 2d 86 (7th Cir. 1979). A high degree of recklessness is not required because if it were, the purposes of the statute could be frustrated simply by delegating responsibilities within a business and adopting a "hear no evil – see no evil" policy. *See* Wright v. United States, 809 F. 2d 425 (7th Cir. 1987). "A 'responsible person' is liable if he (1) clearly ought to have known that (2) there was a grave risk that withholding taxes were not being paid and if (3) he was in a position to find out for certain very easy." *Id*. at 427. Willfulness can be established by a showing of gross negligence as in a situation in which a responsible party ought to have known of a grave risk of nonpayment and is in a position to easily find out, but does nothing. *See* Branson v. Department of Revenue, 168 Ill. 2d 247, 253 (1995).

In this case, JOHN DOE was alerted of DOE's financial problems throughout the tax period in controversy. He was aware that his substantial loans to the corporation were not being repaid and that the corporation was not paying him all of the rent it owed him. Tr. p. 69. He was also aware that the corporation filed for bankruptcy. Tr. pp. 68, 69. Even with this knowledge, the record contains no testimony that JOHN DOE ever asked his son and DOE's President JIM DOE, the company's controller or its accountants what bills were being paid and what bills were not being paid. Rather, he simply allowed others to make decisions regarding creditor payments and did not direct that creditor delinquencies, including tax delinquencies, be addressed. Nor is there any evidence that he inspected the corporation's records or insisted upon being kept informed of the company's tax situation. The fact that he adopted a "hear no evil – see no evil" policy does not relieve JOHN DOE of liability. Wright v. United States, *supra*. JOHN DOE' failure to see that the company's tax obligations were met during a period when DOE was experiencing dire financial hardships is sufficient to establish willfulness within the context of the statute.

JOHN DOE attempts to rebut the presumption of willfulness through testimony that his son, JIM DOE, was delegated complete responsibility for taxes. Tr. pp. 34, 37, 38. However, the courts have consistently rejected such evidence as a defense to a finding of willfulness by holding that a responsible person cannot escape an obligation to ensure that taxes are paid by delegating this responsibility to others. Wright v. United States, *supra*; Mazo v. United States, *supra*. Applying the criteria enumerated in these cases and the cases noted above, and based on the evidence and testimony summarized above, I conclude that JOHN DOE has failed to rebut the Department's *prima facie* case that he acted willfully in failing to remit the taxes in controversy. Accordingly, I find that JOHN DOE is liable for the tax penalties that have been assessed.

With regard to JIM DOE, the record shows that he was the President and Chief Executive Officer of DOE and a stockholder of the corporation. Tr. pp. 28, 87. DOE's by-laws are not in evidence, so the record does not show what duties and responsibilities were vested in the President and Chief Executive Officer. However, it is reasonable to assume from the testimony that JIM DOE was one of the highest-ranking officers in the corporation. He testified that he exercised control over the corporation, and was responsible for the management of the corporation and oversight of its financial affairs. Tr. pp. 90, 91. While RON DOE, the company's controller was responsible for the preparation of the company's tax returns and the company's tax payments (Tr. pp. 92, 93), JIM DOE admitted that he was ultimately responsible for overseeing tax compliance. Tr. pp. 82, 92, 93.

Clearly JIM DOE, as President of DOE had a duty to make sure that the company's retailers' occupation taxes and withholding taxes were paid as required. As noted earlier, the case law indicates that liability as a responsible officer attaches to those who have the power and responsibility within the corporation for seeing that taxes are paid. Monday v. United States, *supra*. This responsibility is generally found in high corporate officials charged with general control over corporate business. *Id*. Responsibility is not a matter of knowledge but rather a matter of status and authority. Mazo v. United States, *supra*. Applying the criteria enumerated in the foregoing cases, JIM DOE, by virtue of his position and duties as President and Chief Executive Officer had the status and authority necessary to make him a responsible person under the pertinent statutes at issue herein.

Finding that JIM DOE was a responsible person, the next question in whether he willfully failed to pay over the retailers' occupation taxes and withholding taxes that have been assessed. The underlying tax liabilities in this case were incurred during 1993, 1994 and 1995. Throughout this period, JIM DOE concedes that he was clearly aware of DOE's financial problems. Tr. pp. 88, 89. Moreover, the magnitude of the company's tax problems was clearly apparent to JIM DOE at the time the company filed for bankruptcy in January, 1994. Tr. p. 96. The bankruptcy filing clearly indicated that the taxes due to the Department were delinquent. Tr. p. 97.

Since the corporation was clearly having "cash flow" problems throughout the tax periods in controversy (Tr. p. 52), JIM DOE should have known that there was a great risk that liabilities to the Department were not being paid. Moreover, he could easily have determined the company's tax delinquencies by checking with the company's controller, whom he supervised. Since JIM DOE clearly ought to have known of the grave risk that taxes were not being paid, was in a position to find out easily, but did nothing, his conduct is sufficient to establish willfulness. Branson v. Department of Revenue, *supra*.

JIM DOE testified that he was not fully advised of the company's tax problems before it filed for bankruptcy in January, 1994. Tr. p. 96. However, there is no testimony that he ever asked the company's controller whether the company's tax liabilities had been satisfied. The fact that JIM DOE adopted a "hear no evil – see no evil" policy does not relieve him of liability. Wright v. United States, *supra* at 427.

WHEREFORE, for the reasons stated above, it is my recommendation that the notice of penalty liability and notice of deficiency issued to JOHN DOE (NPL AAAA; NOD CCCC) and to JIM DOE (NPL BBBB; NOD DDDD) be affirmed and finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: August 28, 2000